(1)

90-1954

Supreme Court, U.S.
FILED
JUN 17 1991
OFFICE OF THE CLERK

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

---

2 TUDOR CITY
PLACE ASSOCIATES
and 2 TUDOR GARDEN
PARKING CORPORATION,

Petitioners,

-against-

2 TUDOR CITY
TENANTS CORPORATION,
KINNEY SYSTEMS, INC. and
AMERICAN SAVINGS BANK,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Richard A. Epstein
1111 East 60th Street
Chicago, IL 60637
(312) 702-9563
Counsel of Record

Nathan Z. Dershowitz
Dershowitz & Eiger, P.C.
225 Broadway, Suite 2515
New York, NY 10007
(212) 513-7676

Amy Adelson
Of Counsel

QUESTIONS PRESENTED

I. Whether the decision of the Second Circuit below has converted the Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §§3601 et seq. ("the Act") into an instrument of abuse by construing its provisions, in defiance of Congressional intent, to allow unscrupulous tenants to cheat real estate developers by terminating, without cause or compensation, economically desirable, long term financial leases.

II. Whether contracts for "operation, maintenance and management" under Section

3607 of the Act include financial leases that do not obligate a developer-lessee to provide services of any sort to a tenants association in its capacity as lessor.

III. Whether Section 3607 of the Act, which was designed to protect tenants against self-dealing, should be construed to allow tenants to set aside, without cause or compensation, a lease utterly untainted by any form of self-dealing.

IV. Whether Section 3607 of the Act deprives developers of their property under the Due Process and Takings Clauses of the Fifth Amendment.

PARTIES TO THE PROCEEDINGS IN THE COURT WHERE JUDGMENT IS SOUGHT TO BE REVIEWED

The parties in the court below were 2 Tudor Place Associates and 2 Tudor Parking Corp.,* plaintiffs-appellees; and 2 Tudor City Tenants Corp., Kinney Systems, Inc., and American Savings Bank, defendants-appellants.

---

* Pursuant to Rule 29.1 of the Rules of the Supreme Court, petitioner 2 Tudor Parking Corp. states that it has no parent company and no subsidiaries.

TABLE OF CONTENTS

QUESTIONS PRESENTED FOR REVIEW.....i

PARTIES TO THE PROCEEDING IN THE COURT WHERE JUDGMENT IS SOUGHT TO BE REVIEWED.....iii

TABLE OF CONTENTS.....iv

TABLE OF AUTHORITIES.....vii

OPINIONS BELOW.....x

JURISDICTION OF THIS COURT.....x

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED.....xi

STATEMENT OF THE CASE.....1

REASONS FOR GRANTING THE WRIT...12

I. THE COURT OF APPEALS BADLY MISCONTRUED SECTION 3607 OF THE ACT, AND FLOUTED CONGRESS' INTENT TO STRICTLY LIMIT FEDERAL REGULATION, BY HOLDING THAT SECTION 3607 AUTHORIZES TENANTS, UNILATERALLY AND WITHOUT CAUSE, TO TERMINATE A FULLY DISCLOSED, PRE-CONVERSION GARAGE LEASE.....12

A. Section 3607 Does Not Cover the Financial Lease Between Associates and Parking.....13

B. Section 3607 Does Not Apply to Leases That do not Require the Developer To Provide For "Operation, Maintenance, or Management" of the Leased Property.....19

C. Section 3607 Only Applies To "Self-Dealing Transactions," and These Can Arise Only After the Control of the Board is Divided Between the Developer and the Tenants.....22

D. Petitioners' Construction of the Statute is Supported By the Best Reading of the Legislative History.....27

II. THE INCORRECT INTERPRETATION OF THE ACT HAS UNDESIRABLE SOCIAL CONSEQUENCES THAT WILL THWART THE GENERAL INTENTION OF CONGRESS.....37

III. THE ACT, AS CONSTRUED BY THE SECOND CIRCUIT, WORKS AN UNCONSTITUTIONAL INFRINGEMENT OF INDIVIDUAL LIBERTY AND TAKING OF PRIVATE PROPERTY WITHOUT JUST COMPENSATION.....41

CONCLUSION.....46

APPENDIX

Opinion of the
United States Court
of Appeals for the
Second Circuit
(Feb. 5, 1991).....A-1

Opinion of the United
States District Court
for the Southern District
of New York
(May 9, 1990).....A-17

Judgment of the United
States Court of Appeals
Reversing Order
Granting Summary
Judgment to
Plaintiffs
(Feb. 5, 1991).....A-40

Order of the United
States Court of Appeals
for the Second Circuit
Denying Rehearing
(March 21, 1991).....A-42

TABLE OF AUTHORITIES

Bader v. Hiscox,
188 Iowa 986,
174 N.W. 565 (1919)..... 2

In re Carlson,
292 F. Supp. 778
(D. Cal. 1968)..... 32

First English Evangelical Lutheran
Church of Gendlae v.
County of Los Angeles,
482 U.S. 304 (1987).....42

Fletcher v. Peck,
10 U.S. 87 (1810).....15

Garcia v. United States,
469 U.S. 70 (1984) 32

Nollan v. California Costal Commission,
483 U.S. 825 (1987) 42

Park East Apartments, Inc. v.
233 East 86th Street
Corporation,
139 Misc. 2d 806,
529 N.Y.S.2d 674
(Civ. Ct. N.Y.Cty. 1988),
aff'd on other grounds,
143 Misc.2d 60,
543 N.Y.S.2d 610
(1st Dept. 1989).....10,38

Penn Central Transportation Co. v.
City of New York,
438 U.S. 104 (1978).....42

Russello v. United States,
464 U.S. 16 (1983).....16

United States v. General Motors,
323 U.S. 373 (1945) 42

Weinberger v. Ross,
456 U.S. 25 (1982) 32

West 14th Street Commercial
Corporation v. 5 West 14th
Owners Corp.,
815 F.2d 188 (2d. Cir.),
cert. denied,
484 U.S. 850 (1987).....passim

STATUTES AND CONSTITUTIONS

U.S. Const., Amend. V.....41

Condominium and
Cooperative Abusive
Relief Act,
15 U.S.C. §§3601
et seq. (1988).....passim

N.Y. Gen. Bus. Law
§§352-eeee
et seq. (McKinney 1984).....6

MISCELLANEOUS

S. Rep. No. 96-136,
96th Cong., 2d Sess. 52,
reprinted in
U.S. Code Cong. Ad. News
3506-3559.....28,29,30

126 Cong. Rec. 15,963 (1980)....29

126 Cong. Rec. 28,178 (1980)....30

126 Cong. Rec. 28,442 (1980)....29

126 Cong. Rec. 23,444 (1980)....29

R. Clark, Corporate Law,
141-189 (1986)..... 23

Tiffany, Real Property,
§74 (3d ed. 1939).....15

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 924 F.2d 1247, and is set forth in the appendix at A-1. The opinion of the United States District Court for the Southern District of New York is unreported and is reproduced in the appendix at A-17.

JURISDICTION OF THIS COURT

The judgment of the Court of Appeals for the Second Circuit was filed on February 5, 1991. (A-40) The petition for rehearing was denied by order entered on March 21, 1991. (A-42) This Court has jurisdiction to review the judgment of the Court of Appeals pursuant to 28 U.S.C. §1254.

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED

The Fifth Amendment to the Constitution provides, in pertinent part:

> nor shall any person . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

The Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §3607, provides:

> **§3607 - Termination of self-dealing contracts**
>
> **Operation, maintenance, and management contracts; penalty**
>
> (a) Any contract or portion thereof which is entered into after October 8, 1980, and which -
>
> (1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property

serving the condominium or cooperative unit owners in such project;

(2) is between such unit owners or such association and the developer or an affiliate of the developer;

(3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and

(4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,

may be terminated without penalty by such unit owners or such association.

Time of termination

(b) Any termination under this section may occur only during the two-year period beginning on the date on which --

(1) special developer control over the association is terminated; or

(2) the developer owns 25 per centum or less of the units in the conversion project,

whichever occurs first.

Vote of owners of units

> (c) A termination under this section shall be by a vote of owners of not less than two-thirds of the units other than the units owned by the developer or an affiliate of the developer.

Effective date of termination

> (d) Following the unit owners' vote, the termination shall be effective ninety days after hand delivering notice or mailing notice by prepaid United States mail to the parties to the contract.

The Condominium and Cooperative Abuse Relief Act, 15 U.S.C. §3608, provides:

> **Judicial determinations respecting unconscionable leases**
>
> **Lease characteristics; authorization by unit owners; conditions precedent to action**
>
> (a) Cooperative and condominium unit owners through the unit owners' association may bring an action seeking a judicial determination that a lease or leases, or portions thereof, were unconscionable at the time they were made. An action may be brought under this section if each such lease has all of the following characteristics:
>
> (1) it was made in connection with a cooperative or condominium project;

(2) it was entered into while the cooperative or condominium owners' association was controlled by the developer either through special developer control or because the developer held a majority of the votes in the owners' association;

(3) it had to be accepted or ratified by purchasers or though the unit owners' association as a condition of purchase or a unit in the cooperative or condominium project;

(4) it is for a period of more than twenty-one years or is for a period of less than twenty-one years but contains automatic renewal provisions for a period of more than twenty-one years;

(5) it contains an automatic rent increase clause; and

(6) it was entered into prior to June 4, 1975.

Such action must be authorized by the cooperative or condominium unit owners through a vote of not less than two-thirds of the owners of the units other than units owned by the developer or an affiliate by the developer, and may be brought by the cooperative or condominium unit owners through the unit owners' association. Prior to instituting such action, the cooperative or condominium unit owners must, through a vote of not less than two-thirds of the owners of the units other than units owned by the developer or an affiliate of the developer, agree to enter into negotiation with the

lessor and must seek through such negotiation to eliminate or modify any lease terms that are alleged to be unconscionable; if an agreement is not reached in ninety days from the date on which the authorizing vote was taken, the unit owners may authorize an action after following the procedure specified in the preceding sentence.

Presumption of unconscionability; rebuttal

(b) A rebuttable presumption of unconscionability exists if it is established that, in addition to the characteristics set forth in subsection (a) of this section, the lease --

(1) creates a lien subjecting any unit to foreclosure for failure to make payments;

(2) contains provisions requiring either the cooperative or condominium unit owners or the cooperative or condominium association as lessees to assume all or substantially all obligations and liabilities associated with the maintenance, management and use of the lease property, in addition to the obligation to make lease payments;

(3) contains an automatic rent increase clause without establishing a specific maximum lease payment; and

(4) requires an annual rental which exceeds 25 percentum of the appraised value of the leased property as improved: Provided,

That, for purposes of this paragraph "annual rental" means the amount due during the first twelve months of the lease for all units, regardless of whether such units were occupied or sold during that period, and "appraised value" means the appraised value placed upon the leased property the first tax year after the sale of a unit in the condominium or after the sale of a membership or share interest in the cooperative association to a party who is not an affiliate of the developer.

Once the rebuttal presumption is established, the court, in making its finding, shall consider the lease or portion of the lease to be unconscionable unless proven otherwise by the preponderance of the evidence to the contrary.

Presentation of evidence after finding of unconscionability

(c) Whenever it is claimed, or appears to the court, that a lease or any portion thereof is, or may have been, unconscionable at the time it was made, the parties shall be afforded a reasonable opportunity to present evidence at least as to --

(1) the commercial setting of the negotiations;

(2) whether a party has knowingly taken advantage of the inability of the other party reasonably to protect his interests;

(3) the effect and purpose of the

lease or portion thereof, including its relationship to other contracts between the association, the unit owners and the developer or an affiliate of the developer; and

(4) the disparity between the amount charged under the lease and the value of the real estate subject to the lease measured by the price at which similar real estate was readily obtainable in similar transactions.

Remedial relief; matters considered; attorney's fees

(d) Upon finding that any lease, or portion thereof, is unconscionable, the court shall exercise its authority to grant remedial relief as necessary to avoid an unconscionable result, taking into consideration the economic value of the lease. Such relief may include, but shall not be limited to rescission, reformation, restitution, the award of damages and reasonable attorney fees and court costs. A defendant may recover reasonable attorneys' fees if the court determines that the cause of action filed by the plaintiff is frivolous, malicious, or lacking in substantial merit.

Actions allowed after termination of special developer control

(e) Nothing in this section may be construed to authorize the bringing of an action by cooperative and condominium unit owners' association, seeking a judicial determination that a lease or leases, or portions thereof,

are unconscionable, where such unit owners or a unit owners' association representing them has, after the termination of special developer control, reached an agreement with a holder of such lease or leases which either --

(1) sets forth the terms and conditions under which such lease or leases is or shall be purchased by such unit owners or associations; or

(2) reforms any clause in the lease which contained an automatic rent increase clause, unless such agreement was entered into when the leaseholder or his affiliate held a majority of the votes in the owners' association.

STATEMENT OF THE CASE

This case raises important questions about the statutory construction of a federal statute that has widespread ramifications for the conversion of rental properties to condominiums and cooperatives. The statute in question, the Condominium and Cooperative Abuse Relief Act of 1980 (the "Act"), is by any measure an ineptly drawn statute whose substantive provisions are poorly integrated, and whose overall design bears only imperfect relationship to the set of evils that Congress sought to address. But this Court must seek to give effect to the language, structure, context and purpose of poorly crafted statutes, just as it does for well-drafted ones. Where all the loose ends cannot be tied neatly together, the judicial task is to give effect to the main purpose

of the statute by minimizing statutory oversights and errors.

In undertaking this task there are a number of general guidelines that can help to smooth the way. It has long been a rule of statutory construction that statutes designed to prevent the occurrence of fraud and abuse should not be made into an instrument for their creation. What was said of the statute of frauds is equally applicable here. "The purpose and intent of the statute of frauds is to prevent fraud, and the courts will, so far as possible, refuse to permit it to be made the shield for fraud." Bader v. Hiscox, 188 Iowa 986, 174 N.W. 565 (1919). All the provisions of a complex regulatory statute should be given their full weight and effect, in order to obviate the mischief to which the statute is directed, without

creating other greater, and avoidable mischiefs in its place. A statute to protect tenants against developer abuses should not be construed, in defiance of its internal logic and structure and general Congressional intent, as a piece of class legislation that assumes tenants can do no evil, while developers are stripped bare of their legal rights. Similarly, a statute that marks a consciously modest Congressional foray into an area normally reserved to state control should not be misread as a major federal initiative that displaces both state statutory schemes and common law rules directed to the same end -- the control of fraud and abuse.

These well-established principles have been systematically discarded twice by the Second Circuit--in this case, and in its earlier, unfortunate

decision in West 14th Street Commercial Corporation v. 5 West 14th Owners Corp., 815 F.2d 188 (2d. Cir.), cert. denied, 484 U.S. 850 (1987). Both cases give unscrupulous tenants wholly undeserved financial windfalls while casting an unnecessary pall over real estate conversion markets to the enormous detriment of tenants and developers generally.

The miscarriage in question started innocently enough when, on April 2, 1981, petitioner 2 Tudor City Place Associates ("Associates") purchased 2 Tudor Place, an apartment complex with a three story basement garage. On April 30, 1981, Associates and its wholly owned affiliate, petitioner 2 Tudor Parking Corp. ("Parking"), entered into a long term lease for an initial term of 24 years, with options for renewal of 20 and 15

years (the "Garage Lease"). Parking had no lease obligations to operate, maintain or manage the leased space, but was allowed to "use and occupy the demised premises for a garage as hereinafter provided or for any other lawful purpose." Parking could let the space remain wholly idle so long as it paid the stipulated rent. The Garage Lease contained no restrictions on the rates that Parking could charge for the use of its space; and it could sublet its garage space to any third party without prior approval from the landlord. No tenants had acquired any ownership interest in either the building or the garage at the time of this initial lease.

Over a year after the Garage Lease was executed, Associates began the process of converting the 2 Tudor Place complex into a cooperative. In August,

1982, it formed the respondent, 2 Tudor City Tenants Corp. ("Tenants"). The following year Associates filed a plan of conversion from rental units to cooperatives with the Attorney General of New York, where it was reviewed under a state law designed to insure that the proposed conversion as a whole did not work any hardship or fraud upon the tenants.

New York State accepted the plan on November 17, 1983, and ten days later the plan was circulated to the building's tenants, for their examination and approval. In July, 1984, the conversion plan became effective when more than 15 percent of the tenants accepted the offer, as required under New York State's Martin Act. N.Y. Gen. Bus. Law § 352-eeee et seq (McKinney 1984). The tenants who became unit-owners were sophisticated

purchasers who had the benefit of expert legal advice every step of the way.

At the closing, Associates assigned to Tenants its interest, as landlord, in the Garage Lease. As part of the offering, Associates had disclosed the terms of the Garage Lease so that Tenants had precise information as to the cash flow that it would receive as Associates' assignee. The offering disclosed three times what was obvious: "the Sponsor expects to make a profit with respect to the Garage Lease in the future."

As a result of the Garage Lease, and a favorable sublease Parking had entered into with Kinney Systems, Inc. ("Kinney"), Associates was able to reduce the sale price of the units sold to the tenants of its building. The rental payments to Associates, and

after the assignment, to Tenants, over the life of the Garage Lease escalated in accordance with a predetermined schedule, but for each period were set below the anticipated market value of the leased garage space. Initially, Parking was to receive annually some $350,000 more on its Kinney sublease than it paid to Tenants. These profits were used to defray the costs of overall operating expenses, and to cover investor shortfalls from the unsold apartments. Only after several years would any profits be made. Over the life of the lease and its two option periods, Parking was to receive approximately $46,000,000 in rentals from Kinney, and to pay out less than $19,000,000 in rentals to Associates, or its eventual assignee, Tenants. The effective difference over the life of the Garage Lease was $27,000,000, which

when discounted to present value, constituted a gain to Parking of just under $6,000,000.

By October, 1985, a sufficient number of units had been sold to allow the unit owners to elect their own Board of Directors. At a special meeting on June, 17, 1987, the unit owners voted to terminate the Garage Lease, invoking section 3607 of the Act. Shortly thereafter, Tenants struck a deal with Kinney that allowed Kinney to continue to operate the parking garage on the same terms and conditions as under its sublease with Parking. Tenants' machinations were intended to oust Parking from its favorable lease, and to allow Tenants to line their own pockets with the $6 million in anticipated profits that <u>everyone</u> had understood belonged to Parking under the terms of the original

deal. Associates was not so fortunate. As a result of the restructured transaction, it could no longer carry the loan on its unsold apartments, and it went bankrupt.

Associates and Parking commenced this action seeking, among other things, a declaratory judgment that the Garage Lease was not subject to the unilateral termination provisions of section 3607. Jurisdiction was premised on 15 U.S.C. §§3611 and 3612 and 28 U.S.C. §1331. Both the petitioners and respondent moved for partial summary judgment on the issue of whether the termination of the Garage Lease was effective. The Honorable Thomas P. Griesa, employing the same reasoning as had a New York State court in Park East Apartments, Inc. v. 233 East 86th Street Corporation, 139 Misc. 2d 806, 529

N.Y.S.2d 674 (Civ. Ct. N.Y.Cty. 1988), aff'd on other grounds, 143 Misc.2d 60, 543 N.Y.S.2d 610 (1st Dept. 1989), called a temporary halt to Tenants' scam by granting petitioners' motion. The District Court then certified the judgment as final pursuant to Rule 54(b) of the Federal Rules of Civil Procedure and respondent appealed.

On February 5, 1991, the Second Circuit reversed, holding that under section 3607, the Garge Lease was a contract for "the operation, maintenance, or management" of property serving the cooperative unit owners, which could be terminated without penalty by Tenants. Its decision thereby allowed Tenants to obtain the benefits of *both* the low purchase prices *and* the favorable lease with Kinney. Associates, which had complied with all the protective provisions of

New York State law, was left holding the bag. On March 21, 1991, the Second Circuit denied the petition for a rehearing and for rehearing en banc. As matters now stand, the sleight of hand sanctioned by the Second Circuit has rewarded Tenants with a deal more favorable than it, or anyone else, could have obtained in the marketplace.

REASONS FOR GRANTING THE WRIT

I. THE COURT OF APPEALS BADLY MISCONTRUED SECTION 3607 OF THE ACT, AND FLOUTED CONGRESS' INTENT TO STRICTLY LIMIT FEDERAL REGULATION, BY HOLDING THAT SECTION 3607 AUTHORIZES TENANTS, UNILATERALLY AND WITHOUT CAUSE, TO TERMINATE A FULLY DISCLOSED, PRE-CONVERSION GARAGE LEASE

There are two reasons why the Act should not apply to the Garage Lease. First, there is no evidence that section 3607 embraces leases at all, let alone space leases entered into for

financial reasons without any obligation on the developer-lessee to provide for the "operation, maintenance or management" of the leased property. Second, section 3607 only applies when there is self-dealing, which can only arise after some tenants have purchased units and have some voting stake in the management of the building.

A. Section 3607 Does Not Cover The Financial Lease Between Associates and Pparking

The Act contains two key provisions -- section 3607 and section 3608. Section 3607 deals with "any contract" entered into after October 8, 1980, which "provides for the operation, maintenance, or management of . . . property serving the condominium or cooperative unit owners." It allows these contracts to be "terminated without penalty" by the unit owners so long as the contract was

entered into "while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in the corporation." 15 U.S.C. §3607(a)(3).

Section 3608 allows courts to fashion limited remedies for certain leases that are by elaborate statutory tests found to be unconscionable. Section 3608 is very limited in its scope; in contrast, section 3607 confers an extraordinary power on the tenants by allowing them to set aside contracts without any showing of cause. Under section 3607, there is no need to show fraud or duress in the formation of the agreement; nondisclosure of any material terms; or unfair or unconscionable contract terms. Indeed there is no need to go to court at all. Section 3607 creates a self-help

remedy.

Despite its breadth, section 3607 is obscure. The critical term "contract" is left undefined, even though the equally commonplace term "lease" receives a special definition under section 3603(16) of the Act. All leases are contracts insofar as they are created by agreement and not by the force of the state, just as land grants have been held to be contracts. Fletcher v. Peck, 10 U.S. 87 (1810). But, leases are also conveyances, Tiffany, Real Property, §74 (3d ed. 1939), and it is unclear whether, and, if so, which leases constitute contracts within the meaning of section 3607.

Section 3608 creates a very precise regime for leases, allowing for judicial modification on a showing of unconscionable terms only. Section

3609 uses the phrase "contract or lease" in a fashion that suggests a sharp opposition between them. Given Congress' precise use of the term "lease" elsewhere in the Act, it is clear that leases were intended to be covered by one section of the Act, and contracts, excluding leases, by the other.[1]

In West 14th Street, the Second Circuit developed an ingenious but fallacious argument to avoid this sensible construction.

> A "lease" as used in § 3608 is defined narrowly to include only property owned by the developer (or developer affiliated

---

[1] "Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acted intentionally and purposely in the disparate inclusion or exclusion." Russello v. United States, 464 U.S. 16, 23 (1983), quoting United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972).

> companies) leased to the cooperative project; not, as here, cooperative property leased by the cooperative to the developer. § 3603. Hence, the limitations of § 3608 are not undercut if § 3607 is construed to apply to leases where the cooperative association is the lessor.

815 F.2d at 197 (emphasis in original).

The Court then added in a footnote:

> We see nothing anomalous in interpreting § 3607 to apply to leases of cooperative owned property to a sponsor affiliated company but not to leases which run in the other direction. Where the sponsor leases developer-owned facilities to the cooperative, it can hardly be said to be managing, maintaining, or operating that property for the cooperative, absent an explicit reservation of those responsibilities.

Id. at 197-98, n.4.

The peculiar definition of leases under Section 3603(16) of the Act -- namely, only those leases where the tenants are the lessees -- is intelligible only when read against the

backdrop of the legislative history. The reported abuses all took place in Florida and involved recreational leases requiring excessive or unconscionable payments from the tenant-lessees to the landlord-developers. Section 3608(a)(6) limited the reach of that section to leases of this sort entered into before June 4, 1975.

The Second Circuit's ground for distinguishing between leases covered by section 3607 and those covered by section 3608 makes no sense. "Absent an explicit reservation of those responsibilities," there is no more reason to assume a developer-tenant has undertaken service obligations than a developer-landlord. Whether the developer is lessor or lessee, the terms of the lease alone determine whether the lease is a service lease.

If "contracts" under section 3607 do not include leases with developers as landlords, then they do not include leases with developers as lessees.

The Second Circuit misread a limited federal statute as a charter for massive intervention into an area customarily governed by state law. To understand the full scope of its errors, it is necessary to delve further into two issues: first, what is a service lease, and second what is a self-dealing transaction.

B. Section 3607 Does Not Apply to Leases That do not Require the Developer to Provide For "Operation, Maintenance, or Management" of the Leased Property.

Section 3607 reaches only those contracts that provide for the "operation, maintenance, or management . . . of property serving the condominium or cooperative unit owners." Leases that require the

developer to render no services are excluded. The reason for this view is not only textual; it is functional as well. Section 3607 is designed to protect against developer abuses. Developers can skimp on services, a tactic exceedingly difficult for tenants to discover or control, or they can impose on tenants additional burdens through hidden escalation clauses. To protect against these forms of abuse, Congress devised the unilateral termination provisions of section 3607.

Neither of these abuses can be present in a case, like this one, not involving a service contact. Parking had no service obligations which would allow it to cheat Tenants. The only service obligations are minor maintenance obligations imposed on Tenants, as landlord. That Tenants

might shirk its service obligations is hardly a reason to allow it to set aside the Garage Lease. Similarly, the escalation clause contained in the Garage Lease did not impose a hidden burden on Tenants; it benefitted Tenants. Tenants knew exactly how much money it was entitled to receive under the Garage Lease. Tenants simply had to regard the future income flow as a financial asset on its books, which it could then discount to present value, just as if it were a corporate bond.

Even if section 3607 applies to some limited form of leases, under the section's express terms it can apply only where the developer (whether as lessor or lessee) has service obligations to the tenants. Section 3607 should not be read, as it was in this case, to allow tenants to set aside a lease where only the tenants

owe service obligations to the developer.

C. Section 3607 Only Applies to "Self-Dealing Transactions," and these Can Arise Only After the Control of the Board is Divided Between the Developer and the Tenants.

The fundamental purpose of section 3607 can be gleaned from the heading of the section: "Termination of self-dealing contracts." A self-dealing contract is not a contract in which the same person is the only party on both sides of the contract. Were that the case, the contract in question would transfer money from one pocket to the other, a benign occurrence. Self-dealing contracts are the subject of such suspicion because there is only a partial overlap in the identity of the parties, which allows abuse, indeed, a disguised sort of theft to take place. In self-dealing transactions the party who controls the corporate decision is

on both sides of the transaction in different proportions. R. Clark, Corporate Law, 141-189 (1986). The paradigmatic self-dealing transaction is "between a corporation and its directors or officers." Id. at 159. Self-dealing is rightly understood as a "unilateral taking of property rather than a bargained-for distribution of it." Id. at 154. Self-dealing involves exploitation of others, and cannot arise where one person only deals with himself.

The original Associates-Parking Garage Lease was not a self-dealing transaction covered by section 3607 because it was completed before Tenants had an interest in the Lease. Section 3607(a)(3) provides that a contract may be terminated by a cooperative association, without penalty, only if it "was entered into while such

association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association."[2] Cooperative associations have no power to terminate contracts or leases with developers created after the tenants control their association. Any risk of self-dealing has passed when tenants are the masters of their own fate. Nor should they have the power to terminate contracts or leases created before the cooperative association even existed. Section 3607 applies only to those contracts that were formed while there was divided control over the tenants.

---

[2] The reference to a majority of the votes and the definition of "special developer control" in section 3603(22) both preclude the application of section 3607 to cases where tenants have no proprietary interests. One hundred percent of the votes is not a majority, for then there is no minority to be exploited.

The Second Circuit's facile paraphrase of the Act in the decision below obscures this relationship:

> The provision of the . . . Act under which Tenants terminated the lease, § 3607, provides a non-judicial remedy for cooperative associations when the developer, or an affiliate of the developer, has bound the cooperative association to a contract, prior to the time when the developer sells control of the cooperative to the unit-owner purchasers. (emphasis added) (A-5)

The Act contains no such provision: the words "prior to the time" are nowhere to be found in the Act. Their use makes it appear as though section 3607 applies to any transaction that takes place before the tenants assume control over the Board. But the exact language of section 3607(a)(3) recognizes that prior to the tenants taking ultimate control, there are two stages: the first, where the developer has exclusive control, and

the second, where control is divided. Both are covered by the phrase "prior to" tenant control. But the first of these is not covered by the statute; only the second is.

The Second Circuit repeated this textual error later in the opinion when it noted that "preconversion leases and contracts executed by the developer and its affiliates, such as tenant cooperatives with yet unsold shares, are self-dealing agreements." (A-7) But again, the Court failed to recognize the distinction between the two classes of "pre-conversion" agreements: those executed when the developer retains full control over all units, and those executed after divided ownership has taken place. Only the second constitute self-dealing arrangements. The Second Circuit, by giving a broad and unprecedented

interpretation to the concept of a "self-dealing transaction," enormously expanded the scope of federal intervention into rental conversions.

D. Petitioners' Construction of the Statute is Supported By the Best Reading of the Legislative History.

The legislative history of the Act is filled with its own fair share of paradoxes. The vast bulk of that history involves section 3608, whose importance necessarily had to diminish with time since it applies only to leases entered into before June 4, 1975. Congress was primarily concerned about developers who forced their tenants, many of whom had limited income, to become lessees of long term recreational leases containing hidden escalator clauses. Although the Senate sought extensive protection against such leases, the House of Representatives opposed the expansion

of federal power in this area and it prevailed. The remedies under section 3608, therefore, were limited. The Committee Report noted that in reaching a compromise, "the Committee recognized the arguments of developers that, in some circumstances, the leases enabled units to be marketed at substantially lower prices and provided a significant portion of the builder's profit on the project as a whole." S. Rep. No. 96-136, 96th Cong., 2d Sess. 52, reprinted in 1980 U.S. Code Cong. & Ad. News 3506, 3559.

In addition, both supporters and opponents of the Act agreed that the Act was not intended to displace the primary state responsibility in the area. The legislative history on this point at least is clear:

> The Committee does not feel that Federal legislation in this area, except on the subject of long-term

> escalating leasing arrangements for project-related facilities, is presently necessary or appropriate. Although some abuses have occurred in the marketing of condominiums and cooperatives, the states in which they took place have generally responded by enacting excellent and comprehensive regulatory schemes. . . . Given this situation, there appears to be no present justification for the enactment of Federal standards which could conflict with existing state law, and possibly diminish the level of new condominium starts which can make an important contribution to relieving the national shortage of affordable shelter.

Id. at 3556.[3]

Given the extensive consideration of and hard fought compromise over the leases governed by section 3608, the legislative history on section 3607 can

---

[3] For similar views, see also 126 Cong. Rec. 15,963 (remarks of Sen. Williams); 126 Cong. Rec. 28, 442 (remarks of Rep. Reuss); 126 Cong. Rec. 28,444 (remarks of Rep. Ashley).

only be described as mystifying and inadequate. The Committee Report reads in full:

> OPTIONAL TERMINATION OF SELF-DEALING CONTRACTS
>
> Section 509 [now 3607] provides a means whereby the unit owners of a conversion project may terminate a long-term, self-dealing contractual arrangement without having to resort to judicial action.

1980 U.S. Code Cong. & Ad. News 3558.

The discussion of section 3607 in the Congressional Record is equally unilluminating. Senator Williams commented, in passing, that he was:

> pleased to note that the conferees did retain a provision of the Senate bill which provides a federally sanctioned, simple and nonjudicial method by which the residents of a conversion project may void a long term, self-dealing leasing arrangement.

126 Cong. Rec. 28, 178 (1980).

The contrast could not be odder. Congress lavished enormous attention on

section 3608, a complicated provision, confined to leases executed before June 4, 1975, with no long term consequences, but remained bafflingly silent about section 3607, which applies to contracts made after October 8, 1980, and whose significance would necessarily increase over time. Congress gave no consideration to the scope of the remedy provided under section 3607, to the transactions to which it applies, or to any of the issues of statutory construction raised in this petition.

In West 14th Street, the Second Circuit relied on two small strands of this sparse legislative history to justify its expansive reading of section 3607. It first stressed that Senator Williams had used the phrase "long-term self-dealing leasing arrangement" in referring to section

3607. 815 F.2d at 198. In so doing, the Court converted a casual remark into a high theory. Senator Williams' isolated and probably inadvertent comment did not represent a reasoned conclusion about the interaction of sections 3607 and 3608;[4] he did not even mention the two chief limitations on section 3607: that the contract be one for "the operation, maintenance, or management" of cooperative property and that it involve "self-dealing."

Second, the Court cryptically observed that four Senators had referred to "'lease provisions'" in

---

[4] As one court has remarked, "in the course of oral argument on the Senate Floor, the choice of words by a Senator is not always accurate or exact." In re Carlson, 292 F.Supp. 778, 783 (D. Cal. 1968). Moreover, stray comments by a single legislator do not represent the views of the entire legislature. Garcia v. United States, 469 U.S. 70, 76 (1984); Weinberger v. Ross, 456 U.S. 25, 35 (1982).

discussing § 3607." West 14th Street, 815 F.2d 198. Here, the Second Circuit flatly misread the legislative history. Those Senators, who opposed the legislation, were referring to unconscionable recreational leases that contained escalator clauses. 1980 U.S. Code Cong. & Ad. News 3600 (Additional views of Senator Garn, Tower, Armstrong and Lugar). This is the very kind of lease that the Second Circuit had already held did not fall under section 3607. West 14th Street, 815 F.2d at 197-98. In fact, the sentence seized upon by the Second Circuit réfers to a provision of the original bill which ultimately was deleted as a concession to the House, which held more restrictive views on the desirability of the Act.

The Second Circuit's second argument in West 14th Street fares no

better. The Court wrote:

> a line drawn between leases and contracts would exalt form over substance. Leases, a species of contract, may contain covenants that require the lessee to perform certain contractual services for the landlord. . . . Thus, a lease, in substance, may be nothing more than a contract of operation.
>
> Finally, construing this statute so as to permit cooperatives to cancel only maintenance-type contracts but not leases would, contrary to Congress' aim, serve as an incentive to developers to try to retain as much control over cooperative property as possible. For example, a contract for the operation of a laundry room, where the developer retained a fair percentage of the profits would be terminable, while a lease for the same laundry room space where the laundry room-tenant (developer) paid a below market fixed rent would not be. Such an anomalous result would thwart Congress's plan.

West 14th Street, 815 F.2d at 198 (emphasis in original).

This form/substance point does not

explain why section 3607 should apply to a lease, like the Garage Lease here, that does not require the developer to render any services. More generally, the Second Circuit incorrectly assumed that Congress intended the Act to have a broad, even aggressive, scope. At no point in either this case or in West 14th Street does the Second Circuit advert to those key passages of the legislative history that clearly show that Congress meant to leave the regulation of condominium and cooperative conversions primarily to the states.

Congress, with its strong sensitivity to federalism questions, intended the future control of abusive leases to be governed by state law. Its intention is ignored if tenants from Florida to New York can set aside all leases at will without any showing

of unconscionability. Congress deliberately made the under-inclusiveness of federal control a central mission of the Act. Even section 3608, the crux of the Act, could not have been passed if its modest remedies had been applied to future leases. How then can the Second Circuit be correct when it construes the more draconian section 3607 to cover these same leases?

The blunt truth is that even if section 3607 is properly confined to self-dealing service contracts entered into after October 8, 1980, it remains broader in scope than any of the drafters thought possible at the time of its passage. Congress had no "plan" that a more restrictive interpretation of the Act would "thwart." The odd bits of legislative history on which the Second Circuit relied are utterly

unable to justify the juggernaut that it has unleashed in the world of condominium and cooperative conversions.

II. THE INCORRECT INTERPRETATION OF THE ACT HAS UNDESIRABLE SOCIAL CONSEQUENCES THAT WILL THWART THE GENERAL INTENTION OF CONGRESS

The case against the Second Circuit's construction of the Act has a third prong: its widespread invalidation of leases from cooperative associations to developers and their affiliates will frustrate the very conversion of rental housing to condominiums and cooperatives that Congress wished to foster. In this particular case, the consequences of statutory construction appear to be solely distributive: who will receive the $6,000,000 that Tenants has taken from petitioners. But that view is unduly narrow for two reasons.

First, by allowing tenants to set

aside leases without cause, innocent third parties will be prejudiced. In this case, Kinney, the sublessee, has been forced to incur additional expenses to protect its legal position. In other cases, the tenants may terminate a lease only to then demand a higher rent from the original sublessee, or to relet the premises to its competitor. Invalidation of the lease transaction thus has ripple effects that harm innocent third parties.

Second, the invalidation of this lease will have important ramifications for other condominium and cooperative conversions. At one level, there is sheer confusion given that a New York State court has fully vindicated petitioners' view of the Act. Park East Apartments, Inc. v. 233 East 86th Street Corporation, 139 Misc. 2d 806,

529 N.Y.S.2d 674 (Civ. Ct. N.Y. Cty. 1988), aff'd on other grounds, 143 Misc.2d 60, 543 N.Y.S.2d 610 (1st Dept. 1989). Since both state and federal courts have concurrent jurisdiction under the Act, 15 U.S.C. §3611, an unseemly conflict has arisen which will encourage tenants and developers to spurn voluntary settlements, and to rush to court in order to obtain the advantage of a favorable jurisdiction. Unless this Court clears up the statutory tangle, it is doubtful that any prudent developer will ever try to recover either costs or profits through financial subleases. The legal risks are obviously far too great.

This developer caution will not only hurt developers. It will hurt tenants as well. These leases offered advantages to both sides. For developers, they generated a steady

stream of cash from a reliable sublessee of its own choosing. For tenants, they allowed lower prices on condominium and cooperative units, simplifying their financing. By reducing the capital requirements of buyers the financing method used by Associates increased the likelihood that sitting tenants could purchase units at favorable prices, reduced the delay and uncertainty of conversion, and economized on a tenant's lending costs. In a world without friction these might seem to be small advantages, but in a world with high transaction costs, sound business practices depend on an accumulation of small transactional savings.

To benefit the greedy tenants in the instant case, the Second Circuit invalidated a sensible practice and has made it impossible for future tenants

to bind themselves to an agreement that it is in their business interest to follow. There is no reason why that perverse result should stand. It is not compelled by the statute's language, by its legislative history, or by its larger social context.

III. THE ACT, AS CONSTRUED BY THE SECOND CIRCUIT, WORKS AN UNCONSTITUTIONAL INFRINGEMENT OF INDIVIDUAL LIBERTY AND A TAKING OF PRIVATE PROPERTY WITHOUT JUST COMPENSATION

The Second Circuit's extraordinarily broad construction of section 3607 creates serious questions about its constitutionality under the Fifth Amendment to the Constitution. The Fifth Amendment affords two sources of protection to private property against encroachment by the government. The Takings Clause provides that private property should not be taken for public use without just compensation; the Due Process Clause

provides that no person shall be denied life, liberty or property without due process of law.

Although this Court has on occasion narrowly construed these clauses, see, e.g., Penn Central Transportation Co. v. City of New York, 438 U.S. 104 (1978), it has also acknowledged their enormous importance in our constitutional scheme. See Nollan v. California Costal Commission, 483 U.S. 825 (1987); First English Evangelical Lutheran Church of Gendlae v. County of Los Angeles, 482 U.S. 304 (1987). Indeed, the Court has recognized that individual liberty includes the right to dispose of property as an owner sees fit, and that the ownership of property likewise includes the right to dispose of the property owned. See United States v. General Motors, 323 U.S. 373, 377

(1945). The Second Circuit ignored these rulings in its rush to rewrite the law, and has enabled Tenants to infringe on petitioners' constitutionally protected interests.

The protection accorded economic liberty and private property under the Fifth Amendment is not absolute; the state will prevail if (a) just compensation is accorded to the owner of the property in either cash or in kind, or (b) if the state has some interest -- some rational basis -- to justify its restriction on liberty or property rights. But section 3607 of the Act affords no compensation to the real estate developer, either before the lease is made or afterwards. Nor has Congress supplied <u>any</u> justification for section 3607, as that section has now been construed by the Second Circuit.

The Second Circuit heedlessly dismissed these important constitutional isues with a single sentence: "Laws and statutes in existence at the time a contract is executed are considered a part of the contract, as though they are expressly incorporated herein." (A-15) Under this unprecedented standard, the mere publication of a statute allows it to survive constitutional attack. Yet as long as the rational basis test requires Congress to construct some justification to support legislation that divests one of ownership of property, then that standard must be constitutionally infirm.

Clearly, there is no rational basis to support the Second Circuit's construction of the Act. Congress determined that limited relief was necessary to protect tenants who

executed abusive leases before June 4, 1975. It also recognized that there were greater protections under state law for leases executed after that date. No one in Congress thought that section 3607 would play the major role envisioned and implemented by the Second Circuit. The Congressional compromise, achieved to minimize federal intervention in an area traditionally subject to state control, was designed to preclude that effect. There is no rational basis for allowing poor drafting to result in a greater remedy for a lesser evil. Section 3607 of the Act, when applied to the very broad class of transactions covered by the Second Circuit's ruling, seizes property without just compensation and serves no legitimate constitutional end.

CONCLUSION

The issues raised by this case are stark and simple. There is an enormous debate on statutory construction, about the appropriate weight that should be given to text, to structure, to context, to legislative history, and to legislative purpose. Petitioners recognize, indeed insist, that the Condominium and Cooperative Abuse Relief Act is badly drafted. But it is not wholly incoherent. No matter what weight is given to the various factors at issue in this case, the decisions of the Second Circuit in West 14th Street and in this case are clearly wrong and worthy of review, so long as the

applicable rule of construction is not "the tenant must always win."

Respectfully submitted,

Richard A. Epstein
1111 East 60th Street
Chicago, IL 60637
(312) 702-9563
Counsel of Record

Nathan Z. Dershowitz
Dershowitz & Eiger, P.C.
225 Broadway, Suite 2515
New York, NY 10007
(212) 513-7676

Amy Adelson
Of Counsel

Dated: June 12, 1991
New York, New York

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 684—August Term, 1990

Argued: October 17, 1990 Decided: February 5, 1991

Docket No. 90-7739

2 TUDOR CITY PLACE ASSOCIATES and
2 TUDOR GARDEN PARKING CORP.,

Plaintiffs-Appellees,

—against—

2 TUDOR CITY TENANTS CORP., KINNEY SYSTEMS, INC., and AMERICAN SAVINGS BANK,

Defendants-Appellants.

Before:

OAKES, *Chief Judge*,
LUMBARD, and WINTER, *Circuit Judges*.

Appeal from judgment and order of the Southern District of New York, Griesa, *J.*, granting summary judgment to appellees and denying appellant's cross-motion for summary judgment in appellees' suit to avoid appel-

lant's nullification of a parking garage lease pursuant to 15 U.S.C. § 3607 (1988).

Reversed.

NATHAN Z. DERSHOWITZ, New York, N.Y. (Dershowitz & Eiger, P.C., New York, N.Y., Jan Ira Gellis, of counsel), *for Plaintiffs-Appellees.*

YVETTE HARMON, New York, N.Y. (Ross & Hardies, New York, N.Y., Michelle d'Arcambal, of counsel), *for Defendant-Appellant 2 Tudor City Tenants Corp.*

LUMBARD, *Circuit Judge*:

The plaintiffs, 2 Tudor City Place Associates (Associates) and 2 Tudor Garden Parking Corp. (Parking), brought suit against 2 Tudor City Tenants Corp. (Tenants) in the Southern District of New York to prevent the nullification of the lease (between Tenants and Parking) of a parking garage at 2 Tudor City Place.[1] Tenants, a cooperative association, had nullified the lease pursuant to the Condominium and Cooperative Conversion Protection and Abuse Relief Act (Act), 15 U.S.C. § 3607 (1988). The purchasers of the apartments at 2 Tudor City Place believed that they had not been advised that the lease of the garage to Parking improp-

1 Kinney System, Inc. and American Saving Bank were both named as defendants in the amended complaint. However, plaintiffs did not move for summary judgment against those parties.

erly benefited the developer of the cooperative project at the expense of Tenants.

The complaint alleged both an illegal § 3607 termination and common law proxy fraud. Upon cross-motions for summary judgment, Judge Griesa granted plaintiffs' motion as to the § 3607 claim, and denied Tenants' motion. After entering judgment in favor of Associates and Parking, the district court granted Tenants' motion for certification to this court under Fed. R. Civ. P. 54(b).

On appeal, Tenants claims that the district court erred in holding that Tenants had no power to terminate the parking garage lease between Tenants and Parking. We agree and reverse the judgment, and direct entry of judgment in favor of Tenants on the § 3607 claim.

I.

The material facts are undisputed. 2 Tudor City Place is a 333 unit residential complex at 330 East 41st Street, east of Second Avenue. On April 4, 1981, Associates, a partnership, purchased 2 Tudor City Place and an adjacent parking garage. It acquired the ground lease, but not ownership of the land. In that same month, Associates incorporated Parking. The officers and directors of Parking consisted of the principals of Associates. Associates leased the garage to its shell corporation, Parking, which in turn, subleased it to Frances Corrao, the garage operator at that time. The lease between Associates and Parking provided that if ownership of the garage changed, the new owner would replace Associates as lessor if the new owner assumed the covenants in the lease.

On August 5, 1982, the principals of Associates incorporated Tenants. Associates intended to profit from its development of the 2 Tudor City property by selling the shares of Tenants to purchasers of the apartments. Tenants adopted a pre-incorporation contract with Associates whereby Associates sold the building and parking garage to Tenants. The contract transferred to Tenants the leases to which Associates had become a party prior to its sale of 2 Tudor City Place to Tenants. However, the terms of this contract provided that Associates remained free to alter the terms of these leases, which included the lease to the parking garage, subject only to written approval by the party to be charged with the alteration. That is, Associates could change the leases as long as Tenants approved. The effect of such a provision was that until Associates divested itself of a majority of the shares in Tenants, it had unlimited power to alter the terms of the garage lease.

On November 5, 1982, as part of the cooperative conversion process, Associates filed a preliminary prospectus with the New York Attorney General's office, as required by state law. On November 16, 1983, an Offering Plan, similar to a securities registration statement, was accepted for filing by the Office of the Attorney General. It revealed that Tenants had leased the parking garage to Parking. It also disclosed the amount of rent Parking was to pay Tenants, that Tenants was responsible for major repairs to the garage and that the ultimate expiration date of the lease was April 30, 2040, with a right to extend the lease if the ground lease is renewed. Although the Offering Plan revealed that the rent Parking was to pay Tenants under the lease was then $340,000 annually,[2] it did not reveal the market value of

2 Under the lease, the annual rent escalates $10,000 every five years.

the garage lease. Parking presently collects $775,000 annually from Kinney Systems, Inc., the sub-lessee and current garage operator. Thus, for at least fifty years, Tenants is bound to a lease under which the rent it receives will almost certainly be substantially less than the market value of the garage.

Associates held two closings at which it sold cooperative shares to unit-owner investors in Tenants: on July 24, 1985, it divested itself of 106 of the 333 units, and 103 of the remaining units were sold on October 1, 1985. At the first closing, Associates and Tenants executed an assignment and assumption whereby the rights and duties of Associates as landlord of the garage lease were transferred to Tenants.

On July 17, 1987, the shareholders of Tenants voted to terminate the garage lease with Parking pursuant to § 3607. On August 13, 1987, Associates and Parking brought this action claiming that Tenants had no right to terminate the lease.

The provision of the Condominium and Cooperative Conversion Protection and Abuse Relief Act under which Tenants terminated the lease, § 3607, provides a non-judicial remedy for cooperative associations when the developer, or an affiliate of the developer, has bound the cooperative association to a contract, prior to the time when the developer sells control of the cooperative to the unit-owner purchasers. In such cases, the cooperative association may, by a two-thirds vote of the unit-owners, terminate the contract within two years of the time when the developer, or its affiliate, has relinquished control of the association or owns less than twenty-five percent of the apartments in the project.

The district court found that the assignment and assumption of the garage lease, executed concurrently with the July 24, 1985 closing, terminated the old lease and created a second lease. Instead of one garage lease, the district court termed the pre-assignment and assumption portion of the lease the "pre-closing lease", and held that as a result of the assignment and assumption, a second "garage lease" was created. Judge Griesa further held that because Tenants was not a party to the "pre-closing lease", signed by Associates and Parking, it had no power to terminate that lease under the authority of the Act.

II.

Tenants contends that the district court erred by holding that it had no power to terminate the garage lease. We agree. There is only one garage lease relevant to this case. That lease was originally executed by Associates, as lessor, and its related shell corporation, Parking. After the 1985 assignment and assumption, Tenants came to stand in Associates' place as lessor of the garage to Parking.

The garage lease, initially signed by Associates and Parking in 1981, provided that in the event ownership of the garage should change, the purchaser would become the new landlord if it assumed all the obligations of Associates. At the first closing in 1985, Tenants, still under the control of Associates, agreed to assume these responsibilities and thereby it became the lessor of the garage. The lease further provided that "[t]he covenants and agreements contained in this Lease shall bind and inure to the benefit of [the current lessor's] successors and assigns." Thus, by its terms, the lease expressly

allowed for the assignment and assumption of the lessor's rights and duties.

Associates argues that Tenants was not an original party to the Associates-Parking lease, and hence could not terminate it. To the contrary, if the formality of which party signed the operative document in § 3607 terminations was given legal effect, it would undermine the policy of the Act. Pre-conversion leases and contracts executed by the developer and its affiliates, such as tenant cooperatives with yet unsold shares, are self-dealing agreements. The developer stands on both sides of the bargaining table because it still controls its affiliate. Because the developer controls all parties at the pre-conversion stage, it can, as Associates did, enter into a self-dealing contract with an affiliate and then transfer its contractual obligations to a cooperative association. Not to apply § 3607 merely because the developer has altered the form of its self-dealing transactions would provide an easy avenue for avoidance of that provision of the Act, the purpose of which was to "alleviate developer abuses during the conversion process." *West 14th Street Commercial Corp. v. 5 West 14th Owners Corp.*, 815 F.2d 188, 190 (2d Cir.), *cert. denied* 484 U.S. 850, 871 (1987).

The recent decision in *Coliseum Park Apartments Co. v. Coliseum Tenants Corp.*, 742 F. Supp. 128 (S.D.N.Y. 1990) is in accord with our conclusion. In that case, as here, the garage lease at issue had been executed by the sponsor and its affiliate before the formation of the tenant cooperative and the filing of the offering plan with the state Attorney General, and the lease provided that the new owner would become the lessor in the existing garage lease if the new owner assumed its obligations.

Unlike the case at bar, there was no assignment and assumption agreement passing the rights and duties of the sponsor/landlord to the tenant corporation. Nevertheless, Judge Leisure held that at the closing, the cooperative became the party to the garage lease with the developer's affiliate, and therefore, the lease could be terminated by the cooperative association because it was between the sponsor's affiliate and the cooperative association. *See also Bank of New York, Albany v. Hirschfeld*, 37 N.Y.2d 501, 506, 374 N.Y.S.2d 100, 103 (1975) (similar lease provision held to transfer rights and obligations of lessor to purchaser of real estate upon purchaser's failure to object to lease covenants). Tenants became the lessor of the garage when it assumed the duties of landlord in 1985 in accordance with the terms of both the lease and the assignment and assumption. Hence, it had the power under § 3607 to terminate the lease with Parking.

III.

Associates contends that § 3607 does not apply to leases because the text of the section references only "contracts". There is no merit to this contention. Nothing in the extensive legislative history of the Act suggests that Congress meant to exclude leases from the term "contract". The lease was a contract which provided for the "operation, maintenance and management" of a garage which "serv[ed] the . . . cooperative unit owners." 15 U.S.C. § 3607(a)(1). As we recently held in *West 14th St.*, § 3607 covers leases as a species of "contract". 815 F.2d at 197-98. Thus, Tenants could avail itself of the termination remedy under the Act.

IV.

Further, the undisputed facts in the record show that the lease falls within the limitations prescribed in §§ 3607(a)(1)-(4), and accordingly Tenants was empowered to terminate the garage lease. Section 3607(a) provides:

> Any contract or portion thereof which is entered into after October 8, 1980, and which—
>
> (1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property serving the condominium or cooperative unit owners in such project;
>
> (2) is between such unit owners or such association and the developer or an affiliate of the developer;
>
> (3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and
>
> (4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,
>
> may be terminated without penalty by such unit owners or such association.

Beyond any doubt, the garage serves the cooperative unit-owners as required by § 3607(a)(1). In *West 14th St.*, we held that a parking garage was "property serving the . . . cooperative unit owners," § 3607(a)(1) even

though the garage did not exclusively serve residents of the building. 815 F.2d at 198-99. To hold otherwise, as Judge Cardamone noted, would permit developers to avoid § 3607 simply by opening a limited number of garage spaces to the public. *Id.* at 198.

After reviewing the statute's legislative history, we concluded in *West 14th St.* that the property need only primarily benefit the unit-owners. 815 F.2d at 198. Tenants' Certificate of Occupancy gave a preference to unit-owners for garage spaces. Because the garage primarily served Tenants, the lease was of the type covered by § 3607(a)(1).

We find that the three other criteria of § 3607(a) are also satisfied. Section 3607(a)(2) requires that the contract be between the "unit owners or such association and the developer or an affiliate of the developer." Section 3603(1) defines affiliate as "any person who controls, is controlled by, or is under common control with a developer."[3]

---

3 Control is defined by § 3603(1):

> A person "controls" a developer if the person (A) is a general partner, officer, director, or employer of the developer, (B) directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interest of the developer, (C) controls in any manner the election of a majority of the directors of the developer, or (D) has contributed more than 20 per centum of the capital of the developer. A person "is controlled by" a developer if the developer (i) is a general partner, officer, director or employer of the person, (ii) directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interests of the person, (iii) controls in any manner the election of a majority of the directors, or (iv) has contributed more than 20 per centum of the capital of the person.

The garage lease was between Tenants and Parking. Parking was incorporated by the principals of the developer, Associates. At all relevant times, the officers and shareholders of Parking were the principals of Associates. Such control of Parking renders it an affiliate of Associates. *See* 15 U.S.C. § 3603(1). Hence, the lease between Parking and Tenants falls within § 3607(a)(2).

Section 3607(a)(3) requires the contract to have been entered into when the developer controlled the cooperative association. Here, Tenants became a party to the lease on July 24, 1985 when it assumed the garage lease. As discussed *infra*, Tenants was under "special developer control" until October 30, 1985, when the unit-owners elected an independent board of directors. Thus, as required by § 3607(a)(3), the lease was "entered into while such association was controlled by the developer through special developer control."

Section 3607(a)(4) states that the contract must extend for at least three years, including any automatic renewal provisions. Here, the garage lease does not expire until April 2005, with automatic renewal by Parking for successive terms of twenty and fifteen years.

Tenants has shown that the parking garage lease was terminable under §§ 3607(a)(1)-(4).

V.

The lease was terminated by the unit-owners within two years of the termination of "special developer control", by a two-thirds vote, as required by § 3607(b).

Section 3607(b) provides that contract termination by the unit owners must occur within two years of the ter-

mination of "special developer control" or when the developer owns only twenty-five percent of the units or less.[4] Section 3607(d) declares that the termination is not effective until ninety days after mailing notice of the requisite two-thirds unit-owners vote. Because Associates owned more than twenty-five percent of the units during all relevant time periods, it is necessary to determine when "special developer control" terminated.

The § 3607 termination vote occurred on June 17, 1987. On June 18, the termination notice was mailed to Associates. Under § 3607(d), it became effective ninety days later on September 16, 1987. For the notice to have been timely, "special developer control" must have existed at least until September 16, 1985.

Section 3603(22) defines "special developer control" as any right arising under state law or by way of a written instrument whereby the developer has power to control the cooperative association. It excludes from this definition the mere ownership of shares allocable to the units still owned by the developer. Thus, Associates claims that "special developer control" terminated on July 24, 1985, the date of the first closing. On that date, 22,985 shares allocable to 106 apartments were sold to shareholders. Although Associates still held a majority of the shares in Tenants, this was not a relevant factor according to § 3603(22). Conversely, Tenants asserts

---

4 Section 3607(b), in its entirety, states:

> Any termination under this section may occur only during the two-year period beginning on the date on which—
>
> (1) special developer control over the association is terminated; or
>
> (2) the developer owns 25 per centum or less of the units in the conversion project,
>
> whichever occurs first.

that "special developer control" terminated on October 30, 1985, when the first independent board of directors was elected.

Special developer control did not terminate until Tenants elected an independent board of directors. In *West 14th St.*, we equated "special developer control" with developer domination of the cooperative board of directors. 815 F.2d at 200. In addition, both *Brabert Realty Co. v. 20125 Owners Corp.*, 703 F. Supp. 314, 316-17 (S.D.N.Y. 1989) and *181 East 73rd Street Co. v. 181 East 73rd Tenants Corp.*, 87 Civ. 3362 (S.D.N.Y. May 2, 1988) have held that the developer exercises "special developer control" when it dominates the cooperative's board of directors. In the case at bar, the unit-owners did not elect an independent board of directors until October 30, 1985. Therefore, the effective date of the leasehold termination, September 16, 1987, is within the two year limitation of § 3607(b), and is timely.[5]

VI.

The disclosure of the lease and its terms in the Offering Plan did not deprive Tenants of its right to terminate the lease, as Associates argues.

---

5 Associates also makes a related argument that Tenants did not terminate the lease in a timely manner given the six year statute of limitations in 15 U.S.C. § 3613 (1988). However, § 3613 reads:

> No *action* shall be maintained to enforce any right or liability created by this chapter unless brought within six years after such action accrued . . .

(emphasis added). It is Associates, not Tenants, which seeks to enforce rights under the Act. Section 3613 does not set a limitation on the time for contract termination under § 3607, a non-judicial remedy. Rather, it is § 3607(b) that serves as a time limitation on such terminations.

Facially, the statute is devoid of any indication of a disclosure defense. To read such a defense into the statute would render § 3607 little more than a disclosure statute. In addition, it is unrealistic to expect prospective homeowners to understand all the financial data revealed in the offering materials. The average cooperative buyer is vulnerable to the practices of developers who may bury the hidden costs of self-dealing contracts in lengthy, legally-mandated disclosure documents. Indeed, in this case, Associates, disclosed the rent and the long-term nature of the lease in the midst of its 607 page Offering Plan. Yet, it did not disclose the disparity between the garage's market value and the rent Parking was to pay Tenants. The Offering Plan merely stated that Associates expected, "to make a profit with respect to the Garage Lease in the future." Only a legal or real estate expert could discern the possible extent of such profit. The amount of this profit would not become known to the typical purchaser of Tenants shares until Associates relinquished control of Tenants, and an independent board of directors was elected.

In *West 14th St.*, we rejected the developer's contention that § 3607 was inapplicable because the contracts were the result of negotiations with the tenant group. 815 at 200-201. The situation presently before the court is a more compelling case for allowing a § 3607 termination. Unlike *West 14th St.*, there was no direct disclosure in negotiations. The only disclosure of the self-dealing lease was buried in the offering materials. *See also Coliseum Park*, 742 F. Supp. 128 (S.D.N.Y. 1990) (declining to construe § 3607 as having a disclosure defense).

VII.

The provisions of § 3607 which authorize the termination of developer dominated arrangements do not violate the fifth amendment proscription that "private property [shall not] be taken for public use without just compensation."

Congress passed the Act in 1980. The garage lease was executed the following year. Laws and statutes in existence at the time a contract is executed are considered a part of the contract, as though they were expressly incorporated therein. Hence, the Act does not violate the takings clause.

VIII.

Judge Griesa disposed of this case below by granting Associates' motion for summary judgment and denying Tenants' motion for summary judgment. Associates argues that even if we reverse the district court's judgment in its favor, summary judgment in favor of Tenants should not be directed because there are material issues of fact relating to whether Tenants' proxy statement was fraudulent and whether Tenants' board of directors ratified the garage lease. We disagree.

Associates has not alleged any facts to support the proxy fraud and ratification claims, it relies instead on Fed. R. Civ. P. 56(f), which gives the district court discretion in denying summary judgment when it appears from the non-movant's affidavits that more discovery is necessary before a decision should be made.

Rule 56(f) is of no aid to the plaintiffs. Even if Associates was allowed to conduct discovery as to proxy

fraud and ratification, those claims do not constitute a defense to a § 3607 termination. The Act is devoid of any indication that state law claims serve as a supplement to what Congress enacted. The only procedural requirement for the termination vote is that two thirds of the unit-owners, exclusive of units owned by the developer, must approve of the termination. 15 U.S.C. § 3607(c). Associates has not alleged that this requirement was not met. The other points advanced by Associates and Parking do not merit discussion.

IX.

There being no issue of material fact, the judgment of the district court is reversed with instructions to grant summary judgment in favor of Tenants on the § 3607 claim.

720—2-8-91 • USCA—80004 FY90
RECORD PRESS, INC., 157 Chambers St., N.Y. 10007 (212) 619-4949

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - - - - - - - - - - - - - - X

2 TUDOR CITY PLACE ASSOCIATES and 2 TUDOR GARDEN PARKING CORP.,

87 CIV. 5850 (TPG)

Plaintiffs,

-against-

OPINION

2 TUDOR CITY TENANTS CORP., KINNEY SYSTEM, INC. and AMERICAN SAVINGS BANK, FSB,

Defendants,

- - - - - - - - - - - - - - - - - - X

2 TUDOR CITY TENANTS CORP., WILLIAM MACARTHUR, EDAN UNTERMAN, JODY SCHAEFFER, GRACE LURTON, NEIL JANSEN, JOSEPH LAPOINTE and WILMA P. GOTTLIEB,

Defendants and Additional Plaintiffs on Counterclaims,

-against-

SEAFIELD ASSOCIATES, et al.,

Additional Defendants on Counterclaims.

- - - - - - - - - - - - - - - - - - X

This action arises out of the cooperative conversion of an apartment building. Plaintiff 2 Tudor City Place

Associates ("Associates") was the owner of the building and sponsor of the conversion. The other plaintiff 2 Tudor Garden Parking Corp. ("Parking") is an affiliate of Associates and is the lessee of the building's garage.

Following the cooperative conversion, the new owner of the building, defendant 2 Tudor City Tenants Corp. ("Tenants Corp.") purported to terminate the garage lease pursuant to The Condominium and Cooperative Abuse Relief Act of 1980, 15 U.S.C. §§3601 et seq. In this action plaintiffs request a declaratory judgment to the effect that Tenants Corp. had no right to terminate the garage lease and that the garage lease in favor of Parking is still in existence. The right eight claims of the eleven-claim amended complaint relate to this request. The next two

claims seek relief designed to protect plaintiffs in the event that the court should rule that Tenants Corp. had the right to terminate the garage lease. In claims nine and ten plaintiffs allege that, if the garage lease is held to be terminable, plaintiffs are entitled to nullify the entire cooperative conversion on the basis of unilateral mistake, mutual mistake, or unjust enrichment. Finally, in claim eleven plaintiffs seek a judgment against defendant Kinney System, Inc. requiring Kinney to honor Parking's sublease with it.

Tenants Corp. and certain individual apartment owners have filed counterclaims seeking a declaration that the garage lease was properly terminated under the above statute and is void under certain other legal doctrines. A claim is also asserted

against Kinney seeking a declaration of Tenants Corp.'s rights against Kinney. Additional defendants are brought in one of the counterclaims, consisting of parties connected with Associates.

Another set of pleadings has been interposed setting up various claims by way of interpleader. The caption on the interpleader matter lists a host of parties and is not included in the caption for this opinion. The interpleader does not change the basic issues in the case.

The issue which is at the foundation of this litigation is whether the new owners of the cooperative had a right to terminate the garage lease under the federal statute. The positions of the two sides on this question have been set forth in cross-motions for summary judgment.

The court has determined that the statute gave Tenants Corp. no right to terminate the garage lease.

FACTS

On April 1, 1981 Associates purchased 2 Tudor City Place, an apartment building in New York City. In the basement of the building is a three-story garage. On April 30, 1981 Associates as lessor entered into a long-term lease for the garage with its affiliate Parking as lessee. The expiration date of the lease is April 30, 2005. The lease includes two renewal provisions, one for 20 years and the other for 15 years. The April 30, 1981 lease was amended by three supplements. The first supplement dated September 15, 1982 changed the rental terms. The second supplement dated January 24, 1983 shifted the

obligation to maintain the garage elevator from Parking to Associates. The last supplement dated April 12, 1984 changed the case year in the tax escalation clause from 1970-71 to 1986-87. On July 2, 1984 Parking entered into a sublease with defendant Kinney to operate the garage premises.

On August 5, 1982 Associates began the process of converting the building into a cooperative and formed defendant Tenants Corp. On November 17, 1983 the cooperative plan was accepted for filing by the Attorney General of the State of New York. On November 27 the offering plan was distributed to the building's tenants. On July 18, 1984 the plan was declared effective because 62 tenants had signed subscription agreements -- more than 15 percent of the building's tenants.

The offering plan disclosed and

described the existing garage lease between Associates and Parking. The "Special Risks" section of the plan stated that:

> The Apartment Corporation [Tenants Corp.] will acquire the Leasehold Property subject to a Garage Lease with 2 Tudor Garden Parking Corp., an affiliate of the Sponsor [Associates], which provides for an initial term expiring on April 30, 2005 with provisions for a first renewal term of 20 years and a second renewal term of 15 years. The Sponsor represents that present and future rent payable by the tenant [Parking] is sufficient to cover the ordinary expenses fairly attributable to the leased space. The Sponsor expects to make a profit with respect to the Garage Lease in the future.

The statement that "the Sponsor expects to make a profit with respect to the Garage Lease in the future" appeared at three places in the plan. See The Cooperative Offering Plan, at v, 108, 119. Subsequent amendments to the plan disclosed the changes made by the supplements to the garage lease.

The profit expected to be earned

by Associates' affiliate, Parking, from the garage lease affected the financial structure of the conversion. The expected profit enabled Associates to sell the apartments at lower prices and to cover any shortfall between the rent received from the apartments not purchased and their carrying charges.

Two closings were held. At the first closing on July 25, 1985, 106 apartments were purchased; the remaining 227 apartments were transferred to Associates. As part of the first closing, among other things, Associates assigned to Tenants Corp. its interest as lessor on the garage lease. At the second closing on October 1, 1985, 103 of the remaining 227 units were sold.

On October 30, 1985 Tenants Corp.'s first independent board of directors was elected. Thereafter, the

board decided to propose that the shareholders terminate the garage lease pursuant to The Condominium and Cooperative Abuse Relief Act of 1980 and obtained a shareholder vote to this effect.

As will appear hereafter, Tenants Corp. now takes a rather confused stance about what it was that it actually terminated. In certain of its submissions, Tenants Corp. argues that the attempted termination applied not only to the garage lease of 1981 but also to the assignment of 1985. Therefore it is necessary to examine with some precision what was actually done in this regard.

On May 26, 1987 the new board of directors of Tenants Corp. sent to the shareholders a notice of a special meeting to be held on June 17, 1987. This notice stated that a resolution

would be submitted to the special meeting

> terminating the Garage Lease which has an initial term expiring on April 30, 2005 (with a provision for a first renewal term of 20 years and a second renewal term of 15 years.)

This obviously referred to the 1981 garage lease. No mention was made of the 1985 assignment.

The notice was accompanied by a proxy statement dated May 26, 1987. The board of directors announced that is was soliciting the proxy of each shareholder to vote in favor of "termination of the garage lease." The details of the garage lease were described, and the description clearly related to the 1981 lease. No mention was made of the 1985 assignment. Each shareholder was asked to execute a proxy, indicating a vote in favor of or against "Termination of Garage Lease." There was nothing in the proxies about

the 1985 assignment.

At the June 17, 1987 meeting the resolution recommended by the board was passed by a vote of 213 apartment owners to 6. The minutes of that meeting have not been submitted to the court to show the actual wording of the resolution. However, the court has been furnished with the "Report of Inspectors of Voting," which records the votes for and against what is described as "Termination of Garage Lease." Again, no mention was made of the 1985 assignement [sic].

It can hardly be questioned that what was voted on by the new apartment owners was the termination of the 1981 lease, nothing more, and nothing less.

No vote of the unit holders was ever taken subsequent to the June 17, 1987 meeting to terminate the 1985 assignment.

DISCUSSION

The relevant statutory provision is 15 U.S.C. §3607(a), which states that a cooperative association such as Tenants Corp. has the right to terminate any contract that:

> (1) provides for operation, maintenance, or management of a . . . cooperative association in a conversion project, or of property serving the . . . cooperative unit owners in such project; (2) is between such unit owners or such association and the developer or an affiliate of the developer; (3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and (4) is for a period of more than three years . . . .

All four elements must exist for a contract to be terminated under the statute. West 14th St. Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188, 197 (2d Cir.), cert. denied, 484 U.S. 850 (1987).

A termination of a contract under

§3607(a) shall be by a vote of owners of at least two-thirds of the units other than those owned by the developer. §3607(c). There is also a time limit under the statute for terminating a contract. Under the provision relevant to the present case, the termination must occur within two years following the date on which control by the developer over the cooperative association is terminated. §3607(d). In the present case this date was October 30, 1985.

In the present litigation, Tenants Corp. argues that the 1987 termination related to both the 1981 garage lease between Associates and Parking and also the 1985 assignment from Associates to Tenants Corp. In its answer, Tenants Corp. states that it terminated a contract which it defines as a combination of the 1985 assignment and

the 1981 garage lease. In its initial memorandum of law submitted on the motions, Tenants Corp. relies on the combination approach by defining the garage lease as being the 1985 assignment. In its reply memorandum of law, Tenants Corp. plays a variation on the combination approach by arguing that it terminated "the total documentary package creating Tenants Corp.'s rights and obligations to Associates, as created by the Assignment and Assumption Agreement and the underlying leases." Finally, in its supplemental memorandum of law, Tenants Corp. argues that the 1981 garage lease was an unenforceable illusory agreement that did not have any legal effect until it "came into legal existence" through the 1985 assignment.

The problem with all this is that

the shareholders of Tenants Corp. only voted to terminate the 1981 garage lease. They did not vote to terminate the 1985 assignment, nor did they vote to terminate a combination of the lease and the assignment.

The essential question therefore is whether the shareholders of Tenants Corp. had a right to terminate the 1981 garage lease under §3607(a). The clear answer is that they did not. The lease was not entered into between the "unit owners or such [cooperative] association and the developer or an affiliate of the developer," within the meaning of §3607(a)(2). Nor was the garage lease entered into "while such [cooperative] association was controlled by the developer," within the meaning of §3607(a)(3). The 1981 garage lease was between the future developer of the cooperative,

Associates, and an affiliated corporation, Parking. But Parking was not, and never became, the cooperative association. No such association and no unit owners even existed in 1981, which was long before the cooperative plan became effective and over a year before Tenants Corp. was created.

None of the supplements to the lease was entered into between Associates and Tenants Corp. Each was between Associates and Parking. The date of the last supplement was three months before the cooperative plan became effective.

The reasoning in Brabert Realty Co. v. 20125 Owners Corp., 703 F.Supp. 314, 317 (S.D.N.Y. 1989), applies.

> Had the sponsor entered into the self-dealing leases prior to conversion, they would be immune to termination under the Act and appropriately so because the association would have clear prior notice that such premises were not part of the assets it was

> acquiring in the conversion. If, on the other hand, such self-dealing leases are made on behalf of the association after conversion by the sponsor acting through special developer control, this can deprive the association of assets on which its members may have reasonably relied on in the conversion process.

We must now return to the argument that what was terminated by the June 17, 1987 shareholders vote was actually the 1985 assignment or a combination of the 1985 assignment and the 1981 garage lease. Obviously Tenants Corp. wishes that it could somehow make use of the 1985 assignment in its efforts to terminate the 1981 garage lease, because the assignment was entered into between the sponsor and the cooperative association at a time when the former controlled the latter. But the plain fact is, as earlier stated, that the purported termination vote of June 1987 related solely to the 1981 garage lease. No vote was taken to terminate

the 1985 assignment by itself for in combination with the garage lease. Moreover, the time for talking any further action under §3607(a) expired two years following October 30, 1985 so that a vote regarding the assignment is no longer possible.

Tenants Corp. argues that the garage lease and the assignment are somehow one contract; that the vote of June 1987 was really a vote on this one contract; and since the 1985 assignment was involved, the termination was authorized by §3607(a). But there is no way that the garage lease and the assignment can be considered to be a single contract. They occurred four years apart. Each was entirely distinct in purpose and effect. The garage lease created a tenancy in which Associates was given the rights of a lessor and Parking was given the rights

of a lessee. The 1985 assignment had the effect of transferring Associates' rights as lessor over to Tenants Corp., while continuing Parking as the lessee. There is simply no basis in fact or law for the argument now made by Tenants Corp. that the garage lease and the assignment should be combined and treated as a single contract for purposes of applying §3607(a).

A further argument of Tenants Corp. is that the 1981 garage lease was an illusory agreement and did not "come into legal existence" until it was assigned to Tenants Corp. There is no merit whatever to this argument.

The position of Tenants Corp. in this case runs counter to both the terms of §3607(a) and its purpose. Congress gave tenants the right to terminate contracts between the sponsor and the cooperative corporation which

are made after the tenants have committed to purchase their apartments but before the corporation is free from the sponsor's control. In the present action, Associates entered into the garage lease with its affiliate Parking well before the cooperative conversion had begun and even before Tenants Corp. existed. The offering materials plainly disclosed and described the garage lease. Tenants Corp. and the prospective buyers of the apartments were fully apprised of this lease. The tenants who elected to purchase their apartments had the information necessary to calculate the effect of the garage lease on the value of their apartments. Similarly, Associates had the right to rely on the anticipated profit from the garage lease in working out the terms of the conversion.

An additional comment needs to be

made regarding the supplements to the 1981 garage lease. While the third and last supplement was entered into 3 months before the cooperative plan was declared effective on July 18, 1984, this supplement was made after the offering plan was accepted by the Attorney General and distributed to the tenants. This chronology of events might theoretically pose a problem if a tenant who had subscribed to purchase his apartment prior to the third supplement did not have the opportunity to rescind his subscription.

However, no such problem is presented in this case.. The law provides a mechanism to protect tenants in such a situation. Under New York statute, Associates was required to disclose any material changes in the offering materials and provide any early subscribers with the

opportunities to rescind. See N.Y. General Business law §352-e (McKinney 1984); N.Y. Comp. Codes R & Regs. tit. 13, §18.5(a)(5). In the second amendment to the cooperative offering plan, Associates disclosed its modification of the garage lease. Moreover, after the plan was declared effective, Associates informed the subscribers of their right to rescind.

CONCLUSION

The court grants plaintiffs' motion seeking a summary judgment declaring that the purported termination of the garage lese under 15 U.S.C. §3607(a) was of no effect. The court denies defendant Tenants Corp.'s motion for summary judgment.

SO ORDERED.

Dated: New York, New York
May 9, 1990

THOMAS P. GRIESA
U.S.D.J.

MANDATE

87-cv-5850
DOC #74 GRIESA

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT
------0-------

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 5th day of February, one thousand nine hundred and ninety-one.

Present: HON. JAMES L. OAKES,
Chief Judge
HON. J. EDWARD LUMBARD
HON. RALPH K. WINTER

Circuit Judges,

United States Court of Appeals
Filed
FEB 5 1991
Elaine B. Goldsmith, Clerk
Second Circuit

United States District Court
Filed
APR 3, 1991

---

2 TUDOR CITY PLACE ASSOCIATES and
2 TUDOR CITY PARKING CORP.,

Plaintiffs-Appellees,

-against-

Docket
No.
90-7739

2 TUDOR CITY TENANTS CORP.,
KINNEY SYSTEMS, INC., and

AMERICAN SAVINGS BANK,

Defendants-Appellants.

DOCKETED AS
A JUDGMENT #91-0654
on 4/5/91

Appeal from the United States District Court for the Southern District of New York.

This cause came to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the judgment of said District Court be and it is hereby reversed and remanded to the said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellees.

A TRUE COPY
ELAINE B. GOLDSMITH
CLERK

Elaine B. Goldsmith, Clerk
BY:
Edward J. Guardaro,
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 21st day of March, one thousand nine hundred and ninety-one.

---

2 TUDOR CITY PLACE ASSOCIATES
AND 2 TUDOR CITY GARDEN
PARKING CORP.,
Plaintiffs-Appellees,

-v-

Docket
Number
90-7739

2 TUDOR CITY TENANTS CORP.,
KINNEY SYSTEMS, INC. and
AMERICAN SAVINGS BANK,
Defendants-Appellants.

United States Court
of Appeals
Filed Mar 21 1991
Elaine B. Goldsmith
Clerk
Second Circuit

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Plaintiffs-Appellees 2 Tudor City Place.

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk